



Signed and Filed: November 19, 2014

Dennis Montali

DENNIS MONTALI
U.S. Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
NORTHERN DISTRICT OF CALIFORNIA

In re) Bankruptcy Case
GIRA POLLI OF MILL VALLEY,) No. 12-31524DM
a Limited Partnership,) Chapter 11
Debtor.)

MEMORANDUM DECISION ON APPLICATION
FOR ALLOWANCE OF COMPENSATION

On May 21, 2012, Gira Polli of Mill Valley, LP ("Debtor") filed its chapter 11 case, represented by Cory Birnberg of Birnberg & Associates ("Counsel"). On May 25, 2012, Debtor filed its application to employ counsel, stating that Counsel had "never been employed by Debtor and Debtor has only consulted with the law firm for bankruptcy." See Dkt. Nos. 12 at ¶ 3 and 12-1 at ¶ 4. Counsel thereafter filed a supplemental declaration stating that it had "no prior connection with the Debtor" and "was consulted about filing a Chapter 11 case at various times in 2011 and has given the Debtor intermittent advice and recommendations as to the filing of the Chapter 11 loan workout in bankruptcy and information of cramdown of unsecured lenders." Dkt. No. 25 at ¶ 3.

1 In the supplemental declaration, Counsel stated that it had
2 "briefly corresponded with the secured lenders about the loans,
3 and prepared the bankruptcy petition, and updated it from time to
4 time at the Debtor's request in the event the Debtor could not
5 obtain a loan to forestall the trustee's sale. Eventually, the
6 loan the debtor negotiated did not materialize and Chapter 11
7 filing was necessary." *Id.* Counsel did not disclose that it was
8 owed any fees for this prepetition work.

9 Following confirmation of Debtor's modified chapter 11 plan
10 on August 4, 2014, Counsel filed its first and final application
11 for compensation pursuant to sections 328, 329, 330 and 331¹ and
12 Rules 2002 and 2016. Dkt. No. 236 at ¶ 2. Counsel sought
13 approval of fees in the amount of \$253,561.02 and costs in the
14 amount of \$4,919.70 (for a total of \$258,480.72, of which
15 \$244,880.72 remained unpaid). Dkt. No. 236 at ¶ 2. Counsel's
16 fees included \$45,300.01 for pre-bankruptcy work that "began
17 almost 9 months before the filing." *Id.* at page 7. The
18 corresponding time sheets reflect work performed from July 22,
19 2011, through the petition date. Dkt. No. 236-6 at pages 1-11.
20 The fees for prepetition work related to matters pertaining to the
21 underlying case: negotiations with lenders, preparation of
22 schedules, and discussions of bankruptcy strategy and planning.
23 Dkt. No. 241 at pages 2-6.

24 Tracy Hope Davis, the United States Trustee for Region 17
25

26 ¹ Unless otherwise indicated, all chapter, section and rule
27 references are to the Bankruptcy Code, 11 U.S.C. §§ 101-1532, and
28 to the Federal Rules of Bankruptcy Procedure, Rules 1001-9037.

1 ("UST"), objected to Counsel's fee application on several grounds,
2 one of which is pertinent to the issue addressed in this
3 memorandum decision: that Counsel was a prepetition creditor
4 ineligible for employment under section 327(a) and thus not
5 entitled to compensation. Dkt. No. 239 at pages 3-6.

6 At the hearing on the fee application, the court permitted
7 Counsel to submit further briefing on the issue of whether a court
8 can grant compensation to a professional who did not disclose a
9 disqualifying condition or offer to cure such a condition at the
10 time of filing the employment application. Both Counsel and the
11 UST submitted supplemental briefing on October 10 and October 17,
12 2014, respectively and the court took the matter under advisement.
13 For the reasons set forth below, the court concludes that absent
14 disclosure and waiver of its prepetition claim for unpaid
15 attorneys' fee, Counsel was ineligible for employment.
16 Nonetheless, given that an employment order was entered (albeit
17 without full disclosure by Counsel) pursuant to section 327, the
18 court has the discretion to award compensation under section 328
19 notwithstanding any invalidity of the employment order.²

20 The order approving Counsel's employment was entered in error
21 because court was not provided all relevant information pertaining
22 to potential disqualifying conditions, specifically that Counsel
23 was owed money for services rendered prepetition. In *In re*
24 *Siliconix*, 135 B.R. 378 (N.D. Cal. 1991), the district court held

25
26 ² In its post-hearing brief (Dkt. No. 247), the UST indicated
27 that Debtor was seeking compensation under section 330. Debtor's
28 application, however, indicates that it sought approval of the
fees pursuant to sections 328 and 330. As discussed below, the
court has the discretion to allow fees under section 328, even if
it erroneously approved employment of the professional.

1 that professional persons who are creditors of the debtor are not
2 disinterested and thus cannot be employed under 11 U.S.C. section
3 327(a).³ That case has long been the rule in this district, and
4 all counsel practicing bankruptcy law here are expected to know of
5 it.

6 If Counsel's unpaid prepetition fees had been disclosed, the
7 court would have returned as defective (or "bounced") the proposed
8 order and informed counsel that it would have to waive the fees or
9 not be employed. In other words, the disqualifying condition
10 could have been remedied if known. Counsel now offers to so
11 remedy the problem by waiving all but \$10,000 of those fees. The
12 UST contends that the disqualifying condition cannot now be cured,
13 and even if it could, Counsel was not disinterested during the
14 pendency of the case and thus ineligible for employment, citing *In*
15 *re Madera Roofing, Inc.*, 2014 WL 4796758, *11 (Bankr. E.D. Cal.
16 Sept. 25, 2014) (designated by the court as "not for publication"
17 and stating that "it has no precedential value").

18 The court agrees that Counsel was not validly employed, but
19 it was nonetheless employed by order of the court. The court
20 could vacate the employment order, but the invalidity of the
21 employment does not necessarily preclude compensation. In its
22 initial opposition to the fee application, the UST relied

24 ³ Section 327(a) provides that a trustee (or a debtor-in-
25 possession) "may employ one or more attorneys, accountants,
26 appraisers, auctioneers, or other professional persons, that do
27 not hold or represent an interest adverse to the estate, and that
28 are disinterested persons, to represent or assist the trustee [or
debtor-in-possession] in carrying out the trustee's duties under
this title." (Emphasis added.) Section 101(14)(A), in turn,
defines "disinterested person" to include a "a person that [] is
not a creditor, an equity security holder, or an insider."

1 extensively on *Kun v. Mansdorf (In re Woodcraft Studios, Inc.)*,
2 464 B.R. 1 (N.D. Cal. 2011), in which the court held that an
3 attorney's failure to inform the bankruptcy court of his
4 prepetition relationship with debtor and the full circumstances
5 surrounding his receipt and use of a \$5,000 retainer provided the
6 court "with discretion to deny all of his fees, including his
7 retainer." *Id.* at 10. Denial of the fees was discretionary, not
8 mandatory.

9 While it has affirmed total disallowance of fees for failure
10 to disclose all connections fully,⁴ the Ninth Circuit has not held
11 that the invalidity of an employment results in a per se
12 disallowance of fees.⁵ The court, surprisingly not Counsel, has
13 found that the Seventh Circuit has specifically addressed this
14 issue in a persuasive opinion. In *Kravit, Gass & Weber, S.C. v.*
15 *Michel (In re Crivello)*, 134 F.3d 831 (7th Cir. 1998), a law firm
16 employed pursuant to section 327(a) as counsel for the debtor in
17

18 ⁴ *Neben & Starrett, Inc. v. Chartwell Fin. Corp. (In re*
19 *Park-Helena Corp.)*, 63 F.3d 877, 882 (9th Cir. 1995).

20 ⁵ The Bankruptcy Appellate Panel for the Ninth Circuit
21 ("BAP") has held that valid employment is generally a prerequisite
22 to compensation, although employment can sometimes be approved
23 retroactively. *Mehdipour v. Marcus & Millichap (In re Mehdi-pour)*,
24 202 B.R. 474, 479 (9th Cir. BAP 1996) (observing that when the
25 professional has disqualifying conflict of interest for only some
26 services, "the bankruptcy court has discretion to award or deny
27 compensation for services performed outside of a conflict").
28 Thus, if the conflict is removed or if work is performed outside
of the conflict, compensation is appropriate. The BAP has more
specifically held that a bankruptcy court has discretion to award
compensation for services performed in reliance on an order
approving employment, even if the employment order is later
vacated or reversed on appeal. See *First Interstate Bank of*
Nevada v. CIC Inv. Corp. (In re CIC Inv. Corp.), 192 B.R. 549,
553-54 (9th Cir. BAP 1996). In *CIC*, however, the professional
(unlike Counsel here) had "fully disclosed" its relevant
connections and "all potential conflicts" at the outset.

1 possession had -- like Counsel here -- failed to disclose, prior
2 to entry of the employment order, numerous prior connections with
3 the debtor and insiders. The order was never appealed, but when
4 the connections were finally disclosed for a subsequent hearing on
5 the firm's fee applications (to which the UST for that district
6 had objected), the bankruptcy court revoked the employment order
7 and denied all fees requested. On appeal, the law firm argued
8 that despite the dual prerequisites to employment set forth in
9 section 327(a), i.e., that a professional person be disinterested
10 and hold no interest adverse to the estate, section 328(c)⁶ grants
11 the bankruptcy court discretion to allow fees even where these
12 dual requirements have not been met. The UST contended that since
13 the grant of discretion in section 328(c) applies only as to
14 persons "employed under section 327," it has no application where
15 fees are sought by a professional whose employment was erroneous,
16 i.e., as a result of undisclosed connections and conflicts of
17 interest.

18 The Seventh Circuit framed "the critical question" as
19 "whether a bankruptcy court must deny fees when it subsequently
20 learns that a professional never should have been employed under
21

22 ⁶Section 328(c) provides:

23 (c) Except as provided in section 327(c), 327(e), or
24 1107(b) of this title, the court may deny allowance of
25 compensation for services and reimbursement of expenses
26 of a professional person employed under section 327 or
27 1103 of this title if, at any time during such
28 professional person's employment under section 327 or
1103 of this title, such professional person is not a
disinterested person, or represents or holds an interest
adverse to the interest of the estate with respect to
the matter on which such professional person is
employed.

1 section 327(a) in the first place or whether it has discretion to
2 deny fees." *Id.* at 836 (emphasis in original). The court found
3 that the plain language of section 328(c) provided the answer, as
4 it vests the bankruptcy court with discretion to award or deny
5 fees if "at any time during ... employment" -- including the onset
6 of employment -- a professional person does not meet the dual
7 requirements of section. *Id.* at 837.

8
9 Unlike the [UST's] interpretation [requiring a valid
10 employment order as a prerequisite to the discretion
11 granted in § 328(c)], our reading of the Bankruptcy Code
12 ensures symmetry between §§ 327(a) and 328(c) ... The
13 [UST] would like to use § 328(c) to question
14 collaterally whether a professional should be employed.
15 Section 328(c) does not govern whether a court should
16 employ an interested person; § 327(a) provides the
17 Code's response.

18
19 *Id.* at 839. Accordingly, in order to "give[] full effect to both
20 § 327 and § 328," the court held that even the entry of an invalid
21 employment order under section 327(a) "trigger[s] the bankruptcy
22 court's discretion under § 328(c)." *Id.* at 838.

23
24 The court agrees. Once entered, even if erroneously, the
25 employment order triggers the court's discretion to determine and
26 allow (or disallow) fees under section 328(c). The validity or
27 invalidity of the order does not affect the court's discretion
28 under section 328(c). Counsel has offered to waive all but
\$10,000 of his prepetition fees. He would have had to waive all
of them to have been employed properly. Thus, the reasoning of
the Seventh Circuit in *Crivello* is particularly applicable here
once all prepetition fees are eliminated, removing the
disqualifying condition.

All that said, the court will not approve any of the

1 undisclosed prepetition fees, including the \$10,000 that Counsel
2 still seeks. Moreover, it agrees with the UST that the fees
3 sought by Counsel are excessive given the nature of the case.
4 Even Counsel concedes this, offering to "reduce the amount claimed
5 in this application by \$25,000, as there are times when counsel
6 was not maybe the most effective, or was not successful enough."
7 Dkt. No. 236 at 5:11-14. However, no such deduction was actually
8 made. Additionally, the plan of reorganization circulated to
9 creditors for voting on confirmation on or about June 11, 2014,
10 reflected that Counsel's administrative fees would be \$150,000,
11 which is significantly less than the amount sought just two months
12 later.

13 Despite the inefficiencies conceded by Counsel, Counsel
14 vigorously (and successfully) pursued his client's reorganization
15 notwithstanding formidable odds and opposition. Without Counsel's
16 dedicated assistance, Debtor likely would not have achieved this
17 good result. Therefore, instead of performing a line-by-line
18 analysis of the time records, the court will exercise discretion
19 and simply reduce the fees significantly, an appropriate outcome
20 for an attorney who holds himself out as a bankruptcy specialist
21 who has appeared often before the court and should not have made
22 the error that he did. Counsel is solely responsible for this
23 unfortunate situation and must bear the cost of a hard lesson
24 learned. Yet reducing fees entirely would give the debtor a
25 windfall far disproportionate to Counsel's error.

26 Since the court could deny all fees sought, it will temper
27 its discretion and reduce them in an amount that is appropriate
28 under the circumstances of this case. The final allowances and

1 authorized payments are as follows:

2	Total fees claimed	\$253,561.02
3	Prepetition fees -Disallowed	< \$45,300.01>
4	Costs - Allowed	\$ 4,919.70
5	Previously paid	< \$13,600.00>
6	Voluntary reduction by Counsel	< \$25,000.00>
7	Additional reduction by court	< \$25,000.00>
8	Net to be allowed and paid	\$149,580.71

9 All other objections to the fees are overruled.

10 Counsel should upload an order consistent with this
11 memorandum decision, and serve a copy of the proposed order on the
12 UST in accordance with B.L.R. 9021-1(c).

13
14 *** END OF MEMORANDUM DECISION ***
15
16
17
18
19
20
21
22
23
24
25
26
27
28